No. 91-1191

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

ASSOCIATES IN ADOLESCENT PSYCHIATRY, S.C., MARVIN J. SCHWARZ and JOANNE G. SCHWARZ, Trustees of the Defined Benefit & Contribution Pension Plans and Trusts of Associates in Adolescent Psychiatry, S.C. and all Beneficiaries and Participants Thereunder,

Petitioners,

v.

HOME LIFE INSURANCE COMPANY OF NEW YORK, a New York Corporation, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; HOSPITAL TRUST NATIONAL BANK, a National Banking Association; CANAPARY FINANCIAL CORP., a Corporation; ROBERT CANAPARY, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; RONALD AURE, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; PENSION ACTUARIES, INC., a Corporation; ERIC KRANKE; LEVENFELD, KANTER, BASKES AND LIPPITZ, a Partnership; and JERRY BIEDERMAN,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

This case involves the application of the federal securities laws and ERISA to investments of pension funds by insurance companies. The court below held that the "Flexible Annuity" contract at issue was not a security and that its administration was not subject to ERISA fiduciary standards. The case presents two basic questions:

I.

Whether the annuity exemption from securities regulation of §3(a)(8) of the Securities Act of 1933 applies to an investment contract that shifts a significant portion of the investment risk to the purchaser.

II.

Whether an investment contract under which an insurance company does not guarantee fixed benefits with respect to an ERISA plan can properly be exempt from ERISA's fiduciary standards as a "guaranteed benefit policy" under ERISA §401(b)(2)(B).

LIST OF PARTIES *

In the proceeding below ASSOCIATES IN ADOLESCENT PSYCHIATRY, S.C., MARVIN J. SCHWARZ and JOANNE G. SCHWARZ, Trustees of the Defined Benefit & Contribution Pension Plans and Trusts of Associates in Adolescent Psychiatry, S.C. and all Beneficiaries and Participants Thereunder were the plaintiffs and are the petitioners. HOME LIFE INSURANCE COMPANY OF NEW YORK, a New York Corporation, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; HOSPITAL TRUST NATIONAL BANK, a National Banking Association; CANAPARY FINANCIAL CORP., a Corporation; ROBERT CANAPARY, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; RONALD AURE, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; PENSION ACTUARIES, INC., a Corporation; ERIC KRANKE; LEVENFELD, KANTER, BASKES AND LIPPITZ, a Partnership; and JERRY BIEDERMAN, were the defendants below. The parent corporation of Hospital Trust National Bank is RIHT Financial Corporation, a wholly owned subsidiary of Bank of Boston Corporation.

This petition does not seek review of the ruling below in favor of PENSION ACTUARIES, INC., ERIC KRANKE, LEVENFELD, KANTER, BASKES AND LIPPITZ, a Partnership, and JERRY BIEDERMAN. Petitioners have filed herewith a notice that said defendants have no interest in the outcome of this petition, pursuant to Supreme Court Rule 12.4.

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* This list also satisfies Supreme Court Rule 29.1. Unless noted above, the corporate parties hereto have no parent or subsidiary corporations.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

ASSOCIATES IN ADOLESCENT PSYCHIATRY, S.C., MARVIN J. SCHWARZ and JOANNE G. SCHWARZ, Trustees of the Defined Benefit & Contribution Pension Plans and Trusts of Associates in Adolescent Psychiatry, S.C. and all Beneficiaries and Participants Thereunder,

Petitioners,

v.

HOME LIFE INSURANCE COMPANY OF NEW YORK, a New York Corporation, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; HOSPITAL TRUST NATIONAL BANK, a National Banking Association; CANAPARY FINANCIAL CORP., a Corporation; ROBERT CANAPARY, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; RONALD AURE, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; PENSION ACTUARIES, INC., a Corporation; ERIC KRANKE; LEVENFELD, KANTER, BASKES AND LIPPITZ, a Partnership; and JERRY BIEDERMAN,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

The opinion and judgment of the U. S. Court of Appeals for the Seventh Circuit has not yet been published in the Federal Reporter. It is attached as Appendix A.

The opinions of the U. S. District Court for the Northern District of Illinois, Eastern Division, which were affirmed by the Seventh Circuit, are published at 749 F. Supp. 1162 and 751 F. Supp. 727.

JURISDICTION

The opinion and judgment of the U. S. Court of Appeals were entered on August 23, 1991. Rehearing was denied on October 3, 1991.

Petitioners seek this Court's review pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

15 U.S.C. § 77(c)(a)(8) provides:

> Except as hereinafter expressly provided, the provisions of this subchapter shall not apply to any of the following classes of securities: . . .
>
> Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance

commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia . . .

29 U.S.C. § 1101(b)(2) provides:

(b) For purposes of this part:

* * *

(2) In the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not, solely by reason of the issuance of such policy, be deemed to include any assets of such insurer. For purposes of this paragraph:

(A) The term "insurer" means an insurance company, insurance service, or insurance organization, qualified to do business in a State.

(B) The term "guaranteed benefit policy" means an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer. Such term includes any surplus in a separate account, but excludes any other portion of a separate account.

29 U.S.C. § 1104 provides in pertinent part:

(a)(1) Subject to sections 403(c) and (d), 4042, and 4044, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this title or Title IV.

29 U.S.C. § 1106 provides in pertinent part:

(b) A fiduciary with respect to a plan shall not—

(1) deal with the assets of the plan in his own interest or for his own account,

(2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or

(3) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

STATEMENT OF THE CASE

In 1977, petitioners, as sponsor, beneficiaries and trustees of a defined benefit and a defined contribution pension plan, invested with Home Life Insurance Company ("Home Life") in a variable annuity known as a "Flexible Annuity." Altogether, petitioners invested more than $680,000 plus some $270,000 in life insurance premiums; thousands of other pension beneficiaries invested in Home Life's Flexible Annuity product.[1] Under this contract, Home Life agreed to pay a minimum guaranteed rate of interest, plus a variable "excess" return that was based on the performance of Home Life's investments in its general portfolio. (Opinion Below, Appendix A, pp. 4, 7.) The contract required Home Life to declare the overall interest rate annually.[2]

In order to avoid multistate insurance regulation (particularly by Home Life's home state of New York), Home Life sold its Flexible Annuity through a trust established at the Hospital Trust National Bank (the "Bank") of Rhode Island, a state that did not regulate such contracts.[3] The terms of the trust and the administration agreement appointing Home Life as administrator were not disclosed to petitioners until revealed in discovery in this case.

---

[1] Uncontested Fact 219-220, 249-250. (The parties' exhibits and a statement of Uncontested Facts were submitted to the district court in a Final Pretrial Order on February 3, 1987.)

[2] Joint Trial Ex. 489, PLX. 29.

[3] Uncontested Fact Nos. 162, 170, 171 (Rhode Island had no statute regulating group annuities and no written standards of approval specifically applicable to annuities).

When petitioners learned that Home Life was mismanaging the plan's assets and administration, they filed this ERISA action in 1982 against Home Life and Home Life's actuaries and sales personnel. Securities fraud and RICO counts were added later. When petitioners discovered the existence of the trust and administration agreement, they added the Bank as a defendant. During discovery, petitioners learned that the Bank had allowed Home Life to unilaterally alter the contract and engage in self dealing.[4] The district court granted defendants summary judgment on all counts (729 F. Supp. 1162; 751 F. Supp. 727) and the court of appeals affirmed.[5] Although the court below concluded that Home Life and the Bank were ERISA fiduciaries, it found no breach of duty. Likewise, although the court of appeals concluded that the Flexible Annuity was an "investment contract," it found that contract was not a security.

Petitioners seek review by this Court as the only means to prevent insurance companies and their affiliates from engaging in self-dealing and unregulated administration of the retirement assets of pension plans affecting millions of Americans.

---

[4] Petitioners' original complaint in relevant part sought relief based on the claim that the Flexible Annuity (and the purchase of whole life insurance) was an inappropriate investment vehicle for petitioners' retirement plans. The 1985 pleading alleged that Home Life, with the connivance of the Bank and the other non-lawyer defendants, imposed hidden and unauthorized charges in computing the participants' earnings. The Seventh Circuit's opinion dealt with only one of these charges, the so-called "float" paid to the Bank (Opinion, p. 13), but disregarded the remaining charges of self-dealing and other breaches of fiduciary duty.

[5] This petition challenges the affirmance of summary judgment on the ERISA and securities fraud claims; it does not seek review of the court of appeals' decision with respect to defendants Pension Actuaries, Inc., Eric Kranke, Levenfeld, Kanter, Baskes and Lippitz and Jerry Biederman. The court of appeals' opinion is reproduced as Appendix A to this petition.

REASONS FOR GRANTING THE WRIT

Introduction

The type of annuity contract at issue in this case, under which part of the return is guaranteed and part depends on investment performance, should be subject to the securities laws or to the fiduciary standards of the Employee Retirement Income Securities Act ("ERISA," 29 U.S.C. §1001, et *seq.*), or both. This Court has never reviewed this type of annuity under ERISA, and has not reviewed "flexible" annuities under the securities laws since *S.E.C. v. United Benefit Trust Life Ins. Co.*, 357 U.S. 202 (1967). In the interim, the securities laws have been more fully developed and ERISA was enacted. Since 1965, the amount of retirement assets held by life insurance companies has risen from $27 billion to more than $713 billion; the number of beneficiaries has risen from 7 million to more than 62 million.[6]

Respondents have discovered a subtle but effective means to avoid state or federal regulation of the administration and investment of pension funds. They have accomplished this startling result so far by disguising as a "guaranteed benefit policy" an investment vehicle that in fact shifts substantial risk to the investors. Unless the ruling of the Seventh Circuit is reversed, the gates will have been opened to avoid federal scrutiny of two areas for which the laws of this country have demanded such scrutiny: securities and employee benefits.

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[6] *Life Insurance Fact Book, 1991 Update* (published by the American Council of Life Insurance), pp. 24-25.

A.

The Flexible Annuity Contract Is a Security

Section 3(a)(8) of the Securities Act of 1933 (15 U.S.C. §3(a)(8)) exempts from securities regulation, "[a]ny . . . annuity contract . . . subject to [state regulation]." The courts have held that in order to fall within the §3(a)(8) exemption, the contract cannot shift significant investment risk to the purchaser. In the instant case, the Seventh Circuit did not reach petitioners' securities fraud claims because it concluded that the Flexible Annuity was exempted by §3(a)(8) as an "annuity contract . . . subject to [state regulation]," despite the fact that, (a) the Flexible Annuity shifted significant investment risk to its purchasers, and (b) it was not subject to state regulation. The Seventh Circuit's decision should be reversed because:

1. The ruling below conflicts with *SEC v. United Benefit Life Insurance Company*, 387 U.S. 202 (1967), which held that the §3(a)(8) exemption from securities regulation does not apply to an instrument under which purchasers share in the performance of an investment portfolio with a guaranteed but low minimum rate of return. This Court reasoned that the purchasers of such an instrument necessarily rely on the investment skills of the issuer to maintain earnings in excess of the contractual minimum. (*See* Opinion below, pp. 6-7.) As discussed below, Home Life's board of directors reserved the right to change the declared excess rate based on portfolio performance, thus forcing the purchasers of its Flexible Annuity to rely on its investment skills. Even without that reservation, the fact that Home Life assumed no meaningful mortality risk under the Flexible Annuity, and that the "excess" interest rate varied with the investment per-

formance of Home Life's portfolio, makes the Flexible Annuity a security under *United Benefit*.[7]

2. The ruling conflicts with the facts, which establish that Home Life, (a) unilaterally altered its obligation to declare interest rates annually, and (b) shifted the risk of investment performance to petitioners and its other investors. As the court of appeals acknowledged, "Home Life did begin to change more than once a year the rate of interest it would credit on *new* money." (Opinion at 9; emphasis in original; see also, Uncontested Fact 258.) While the court excused this alteration of Home Life's contractual obligations (a clear violation of ERISA §404(a)(1)(D); 29 U.S.C. §1104(a)(1)(D)) by pointing out that petitioners were "free" to withdraw their money if they did not like the declared rates (although such withdrawal could have tax consequences and incur penalties; Opinion, p. 8),[8] the court failed to deal with the fact that Home Life had avoided committing itself to *any* guarantee of the "excess" rate. Indeed, its board of directors had declared the 1980 rates only on a "provisional" basis, subject to being "reconsidered" by Home Life "after a review of the 1979 financial results and other factors."[9] This action allowed Home Life to change its so-called "excess" rate at will on "new" and "old" money alike, thus requiring the purchasers of the Flexible Annuity to share the risk of performance of Home Life's investment portfolio. The court

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[7] Uncontested Fact 151. Moreover, like the marketing materials in *United Benefit*, Home Life's marketing brochure (Joint Trial Ex. 489) emphasized growth based on the earnings of Home Life's investments.

[8] In fact, under the Flexible Annuity contract, Home Life had the discretion to delay withdrawal for up to six months and reduce the interest rate during that period to the minimum. (PLX 29, p. 7.)

[9] PLX 52, p. 3, attached hereto as Appendix E.

below was therefore incorrect in concluding that the Flexible Annuity was a "series of fixed annuities" (Opinion, p. 8); there was nothing "fixed" about it.

3. The ruling below also conflicts with the Seventh Circuit's opinion in *Otto v. Variable Annuity Life Ins. Co.*, 814 F.2d 1127, 1140-1142 (7th Cir. 1986), *cert. denied*, 486 U.S. 1026 (1988), where the court held that the power to alter excess interest rates at any time on an investment contract issued by an insurance company makes that contract a security not exempt under §3(a)(8). The court based this conclusion on the holdings of this Court in *United Benefit*, *supra*, and *S.E.C. v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959), as well as the then recently promulgated S.E.C. Rule 151 (17 C.F.R. 231.151).[10]

4. The court of appeals, in extending §3(a)(8) relief to Home Life, had to rely on the erroneous statement that "Rhode Island regulated the Flexible Annuity." (Opinion, p. 10.) In fact, the parties had stipulated to the contrary. (See fn. 3, *supra*.) Indeed, Home Life used a Rhode Island bank to *avoid* state insurance regulation, the very safeguard on which the §3(a)(8) exemption is based.

5. The court of appeals has thus created a loophole through which insurance companies like Home Life will escape securities regulation, although the risk of performance of their investment portfolios has effectively been shifted to their customers. Unless this Court closes that loophole, insurance companies will enjoy a unique, unauthorized and unregulated exemption from the securities

[10] Although the contract of the defendant in *Otto*, like that of Home Life in the instant case, was issued prior to Rule 151, the defendant in *Otto*, like Home Life, argued that the contract fell within the safe harbor provisions of the Rule. In the instant case, however, the Seventh Circuit decided not to apply Rule 151 analysis to the Flexible Annuity. (Opinion, pp. 4-5.)

laws that are designed to protect the investments of millions of Americans—pension beneficiaries and ordinary investors alike.

As this Court recently noted, "Congress' purpose in enacting the securities laws was to regulate *investments*, in whatever form they are made and by whatever name they are called." *Reves v. Ernst & Young*, 494 U.S. ____, 110 S. Ct. 945, 949 (1991) (emphasis in original). Home Life's "Flexible Annuity" is such an investment, and thus is a security.

B.

Home Life and the Bank Violated ERISA Fiduciary Duties

Although defendants argued to the contrary, the court of appeals found that Home Life and the Bank were ERISA fiduciaries, but only to the extent that, (a) the Bank appointed Home Life as trust administrator, and (b) Home Life reserved to itself the power to amend terms of the Flexible Annuity. The court then held that, (a) the charges of self-dealing against the Bank did not involve the exercise of its discretion to appoint Home Life as trust administrator, and (b) the charges of self-dealing against Home Life did not involve its power to amend the Flexible Annuity. (Opinion, pp. 11-13.) The court of appeals was wrong, and its error will lead to all kinds of mischief unless its ruling is reversed.

First, the court erroneously concluded that Home Life and the Bank (Home Life's tool for marketing and administering the Flexible Annuity) escaped the broader fiduciary duties over plan assets imposed by §§404 and 406 of ERISA (29 U.S.C. §§1104, 1106) because "the Flexible Annuity is a guaranteed benefit policy." Section 401(b)(2)

of ERISA (29 U.S.C. §1101(b)(2)) provides that when a plan purchases a "guaranteed benefit policy" from an insurer, the assets of the plan include that policy but not an interest in the insurer's assets. Because petitioners' claims involve the manner in which Home Life managed, or mismanaged, the funds in its general asset pool (with which petitioners' plan assets were commingled), the conclusion that the Flexible Annuity was a guaranteed benefit policy freed Home Life and the Bank from any claim of breach of fiduciary duty. (Opinion, p. 11.)

Yet, the court of appeals' conclusion that the Flexible Annuity was a "guaranteed benefit policy" depends entirely on the finding that "Home Life not only set fixed annual rates but also backed its promise with its full assets." (Indeed, the court concluded that its ruling that the Flexible Annuity was not a security compelled the finding that Home Life was not holding the plan assets of petitioners and others in its investment portfolio as an ERISA fiduciary.) (*Id.*) As discussed above, however, Home Life's unilateral claim of the right to alter the "excess" rate on the Flexible Annuity undercuts the premise of the court of appeals' ruling and has the effect of making the Flexible Annuity a security *and* imposing fiduciary duties.

Moreover, and perhaps most egregiously, the court below misapplied ERISA §401(b)(2)(B), under which a policy is exempt from fiduciary standards only "to the extent" that the policy's benefits are "guaranteed by the insurer." Thus, "to the extent" the benefits are *not* guaranteed, they are not exempt. As the drafters of ERISA stated:

> "An insurance company also is not considered to hold plan assets if a plan purchases an insurance policy from it, to the extent that the policy provides pay-

> ments guaranteed by the company. If the policy guarantees basic payments but other payments may vary with, e.g. investment performance, then *the variable part of the policy and assets attributable thereto are not to be considered as guaranteed, and are to be considered as plan assets subject to the fiduciary rules.*" H.R. Rep. No. 93-1280, 93d Cong. Second Session; reprinted at 3 U.S. Code Cong. & Adm. News (1974), 4639, 5077. (Emphasis added.)

The Third Circuit has specifically enforced this principle in *Mack Boring & Parts Co. v. Meeker Sharkey Moffit*, 930 F.2d 267, 277 (3rd Cir. 1991), in which that court held that a guaranteed benefit policy "must be a general account insurance contract in which the issuing insurance company *guarantees to the plan participant a fixed amount of benefits, payable at a clearly stated time.*" (Emphasis added.)

The Flexible Annuity contract in the instant case is not a standard annuity contract; it does not guarantee fixed benefits to plan participants at clearly stated times. In fact, even if the Flexible Annuity had guaranteed annual rates, these rates would not necessarily have satisfied the promised benefits under petitioners' defined benefit plan. The Seventh Circuit's holding that the Flexible Annuity contract was a guaranteed benefit policy, therefore, directly conflicts with the Third Circuit's holding in *Mack Boring*. In fact, because the Flexible Annuity provides that the "excess" interest varies with investment performance (Opinion p. 7), at the very least "to the extent" the payments so vary, they are subject to ERISA's fiduciary rules under the clear language of §401(b)(2)(B).

Thus, the Seventh Circuit's failure to consider or deal with the "to the extent" limitations in §401(b)(2)(B) of ERISA, (a) violates the statute, (b) creates a conflict with

the Third Circuit in *Mack Boring*,[11] and (c) impermissibly allows Home Life and its affiliates to escape the scrutiny that ERISA imposes on fiduciaries who manage and invest plan assets.

C.

The Importance of These Issues Beyond the Litigants to This Case

Home Life has, until now, found a way to avoid all state and federal regulation and scrutiny under both the securities laws and ERISA. It has done so by disguising as a "guaranteed benefit policy" a contract that shifts significant investment risk to its purchasers. Because a beneficiary has no right to scrutinize the internal accounting and asset management procedures under a legitimate guaranteed benefit policy, Home Life and the Bank have prevented the courts from reaching the claims of self-dealing brought by petitioners. Unless the Seventh Circuit's decision is reversed, others will surely follow Home Life's example.

[11] Moreover, as previously mentioned (p. 9, *infra*), Home Life's violation of its contractual obligations also violated ERISA §404(a)(1)(D). The Third Circuit in *Mack Boring* noted that a breach of a guaranteed benefit contract is a breach of fiduciary duty. 930 F.2d at 277, n.20.

CONCLUSION

For the foregoing reasons, petitioners Associates in Adolescent Psychiatry, S.C., Marvin J. Schwarz and Joanne G. Schwarz pray that this court issue a writ of certiorari to the United States Court of Appeals for the Seventh Circuit for purposes of reviewing and reversing the decision of that court.

Respectfully submitted,

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APPENDICES

APPENDIX A

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 90-2800

ASSOCIATES IN ADOLESCENT PSYCHIATRY, S.C., *et al.*,
Plaintiffs-Appellants,

v.

HOME LIFE INSURANCE CO., *et al.*,
Defendants-Appellees.

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 82 C 4706—**John A. Nordberg,** *Judge.*

ARGUED MAY 30, 1991—DECIDED AUGUST 23, 1991

Before COFFEY, EASTERBROOK, and MANION, *Circuit Judges.*

EASTERBROOK, *Circuit Judge.* Associates in Adolescent Psychiatry, S.C., its owner, Marvin P. Schwarz, and his wife (collectively "AAP"), bought a variable annuity and seek relief against Home Life Insurance Company, a Rhode Island bank, and various accountants and lawyers involved in the process. They present claims under the securities acts, ERISA, RICO, and the common law. The district court first granted summary judgment to defendants on the securities and ERISA claims, 729 F. Supp. 1162 (N.D. Ill. 1989), and later granted the defendants' motion for summary judgment on the RICO claims, 751 F. Supp. 727

(N.D. Ill. 1990), leaving only the state claims, which it dismissed under *United Mine Workers v. Gibbs*, 383 U.S. 715, 726 (1966).

I

A defined benefit plan promises specified levels of benefits on retirement. The employer must aside amounts actuarially necessary to fund these future payments. In 1977 Schwarz began looking into the possibility of establishing a defined benefit plan for AAP, the professional corporation through which he rendered psychiatric services. Professional corporations often serve principally as sources of tax benefits. Contributions made by an employer are deductible as ordinary and necessary business expenses. 26 U.S.C. §404(a). As the deduction is limited to the amount necessary to keep the plan fully funded, §404(a)(1)(A), it may be advantageous to purchase instruments with low stated rates of return. The lower the nominal return, the more the plan needs to remain fully funded, and consequently the higher the permissible deduction. If the investment actually earns more than the stated rate of return, permissible contributions (and deductions) in future years are lower, but the taxpayers have enjoyed benefits in the interim.

Home Life offered Dr. Schwarz a defined benefit plan that allowed for greater annual contributions, and hence greater deductions, than other plans he had seen. Home Life achieved this by using a "Flexible Annuity", an instrument with a relatively low guaranteed rate of return. Sums invested in the Flexible Annuity accumulate earnings at an annual guaranteed rate plus a variable excess rate. The Flexible Annuity that AAP ultimately purchased guaranteed a return of 7% during the first year, 6% for the next two years, 5% for the following two years, and 4% thereafter. The variable rate, referred to in the contract as the "annual dividend", is defined as the "excess, if any, of the interest credited to the Participant's Accumulated Account Value over the interest calculated at

the Minimum Interest Rate." The contract provides further that "the interest rate . . . applicable to all funds held under this contract [will be] declared annually by the Board of Directors of [Home Life]".

Home Life wished to sell its Flexible Annuity throughout the country but did not want to submit the product for regulatory approval in every state. To accomplish both objectives Home Life entered into an agreement with Rhode Island Hospital Trust National Bank (HTNB) establishing a "Qualified Corporate Plan Trust". This trust is the sole buyer of Flexible Annuities, so Home Life had only to do what was necessary to qualify its offering in Rhode Island, provided that insurance regulators in other states did not balk. Home Life sells the Flexible Annuity to employers as a group annuity contract. An employer, as the sponsor of the defined benefit plan, sends contributions to Home Life, which wires these amounts to HTNB. The bank, as trustee of the corporate plan trust, uses the money to buy a Flexible Annuity from Home Life. The triple-transfer arrangement (employer to Home Life to HTNB to Home Life) entails some delay. HTNB wires funds to Home Life only on Mondays, so it enjoys the float on money received during the preceding week. Home Life credits employers' accounts as soon as it receives their funds, so it bears the cost of the float. Each employee designated as a beneficiary under the plan must sign an agreement enrolling in the trust; the employee receives a certificate memorializing his participation. Each beneficiary receives annual statements from Home Life of the amounts accumulated by virtue of the employer's contributions and the earnings allocated according to the terms of the Flexible Annuity.

The Employee Retirement Income Security Act (ERISA) requires that plan assets be held in trust. 29 U.S.C. §1103(a). Home Life gave AAP documents establishing a plan trust, naming the two Schwarzes as trustees. Dr. and Mrs. Schwarz executed these documents in July 1977. At the same time, they signed a participation agreement listing them as "Plan Investment Managers". The participation

agreement provided that AAP was to fund the plan with two financial instruments: whole life insurance policies and the Flexible Annuity. AAP made payments under the terms of the Home Life products until 1980. During this period interest rates skyrocketed. Home Life's "excess rate", derived from the return on the insurer's entire portfolio of assets (which was locked into long-term projects), lagged well behind the returns available from short-term investments such as money market funds. This shortfall eclipsed the tax advantages of the plan. AAP regretted its choice and brought this action.

II

The district court concluded that the Flexible Annuity is not subject to registration under the securities laws. We have no doubt that the Flexible Annuity is an "investment contract" and so comes within the broad definitional clauses of the statutes. See *Reves v. Ernst & Young*, 110 S. Ct. 945, 951 (1990); *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975); *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946); *Chicago Mercantile Exchange v. SEC*, 883 F.2d 537, 545 (7th Cir. 1989). Yet almost all insurance and annuity products are securities, broadly understood, because they entail entrusting money to the hands of others in pursuit of appreciation. The Securities Act of 1933 partitions investments between the world of securities regulation and insurance regulation via §3(a)(8), 15 U.S.C. §77c(a)(8), which exempts "[a]ny insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to [state regulation]". AAP conceded at oral argument that the whole life policies come within this exemption. Home Life argues that its Flexible Annuity also falls within §3(a)(8), and the district court agreed.

Both the district court and the parties devoted substantial energy to the SEC's Rule 151, 17 C.F.R. §231.151, which establishes a "safe harbor" for some variable annuities. Only persons who rely on a regulation may claim

the benefit of its safe harbor. 15 U.S.C. §77s(a). Rule 151 became effective on June 4, 1986; Home Life introduced the first version of the Flexible Annuity in 1975; AAP purchased its Flexible Annuity in 1977. The SEC's rules may facilitate understanding of statutory law, see *Otto v. Variable Annuity Life Insurance Co.*, 814 F.2d 1127, 1133 (7th Cir. 1986), but the technical details of Rule 151 do not affect the disposition of this case, which we decide under §3(a)(8).

An ordinary annuity is a promise to pay fixed amounts of money beginning at a time specified in the contract. The seller funds its performance by a combination of the purchase price and income earned by investing that sum. Sellers of annuities invest the receipts in diversified portfolios. All annuities therefore are pooled investment vehicles, but fixed annuities are characterized by a particular division of risk: the buyer obtains a payment stream reflecting assumptions about how well the portfolio will do, and the seller reaps the reward (suffers a loss) if the investments do better (worse). Annuities sometimes contain an element of insurance: they may, for example, promise a monthly payment from retirement until death, so that the total payments are larger the longer the purchaser survives. The seller then bears both investment and insurance risks. For simplicity we disregard the insurance component of annuities (although the Flexible Annuity has such an insurance component).

Traditional annuities in which the exact (monthly or total) amounts to be paid to the purchaser are fixed and are not responsive to inflation. This makes them unattractive to investors who cannot otherwise protect themselves against variation in the value of money. Fixed annuities carry relatively low (implicit) rates of return even in an inflation-free economy, because underwriters cannot readily hedge against changes in the economy-wide rate of return. If the issuer has promised payments that imply a 4% annual return, a decline in the return of its portfolio below this figure produces bankruptcy. In order to reduce

the bankruptcy risk, an issuer makes conservative assumptions about the return to investment. Conservative assumptions yield low returns—which in turn make annuities less attractive compared with, say, mutual funds that deliver to investors the entire return of the portfolio.

The variable annuity responds to both of these problems. Instead of providing fixed payments, the variable annuity contract promises a modest guaranteed return (one low enough to curtail the bankruptcy risk) plus an additional amount to be determined in the future. Some variable annuities tie the level of return to a publicly-reported index—the inflation rate, for example. Another form of the variable annuity contract ties the amount the purchaser receives to the rate of return that the insurer earns on its investment portfolio. Although the purchaser of this type of variable annuity shares in the success of the insurer's investment portfolio, he also bears the risk of a disappointing performance.

No annuity transfers all of the risk to the seller. Any fixed annuity places on the buyer the risk that the seller's portfolio will perform too poorly to finance the promised payments. Section 3(a)(8) therefore necessarily exempts annuities that leave purchasers with some investment risk. If on the other hand a seller just pins the label "annuity" on a mutual fund, in which the buyer bears all of the risk, §3(a)(8) is inapplicable. *SEC v. Variable Annuity Life Insurance Co.*, 359 U.S. 65 (1959), holds that a contract providing for variable payments based on the investors' stakes in a special investment portfolio is not an "annuity contract". The Court reasoned that because there was no guarantee of *any* return, the entire investment risk was borne by the purchaser of the annuity. Where there is no transfer of risk, the exemption does not apply. *Id.* at 71-73. *SEC v. United Benefit Life Insurance Co.*, 387 U.S. 202 (1967), extended "no" to "slight", holding that §3(a)(8) does not apply to an instrument permitting purchasers to share in the performance of an investment portfolio with a guaranteed but low minimum rate of return. These guaranteed rates were well below what would

be provided in a conventional annuity, so that the purchaser relied on the investment skills of the issuer to maintain earnings in excess of the contractual minimum. The Court thought that the dominant aspect of the instrument was that the seller acted as an "investment agency". *Id.* at 208.

How much risk is too much? The Court's opinions do not say, and the parties to our case debate the question vigorously. Our own decisions recognize that a minimal guarantee will not do the trick. *Peoria Union Stockyards Co. v. Pennsylvania Mutual Life Insurance Co.*, 698 F.2d 320 (7th Cir. 1983), considered a contract providing that funds contributed by the purchaser would accumulate earnings at a modest guaranteed rate plus a pro rata share of the insurer's "divisible surplus", the amount earned on the insurer's general portfolio of investments. Relying on both *VALIC* and *United Benefit*, we held that Penn Mutual had sold its investment expertise and not an annuity; by leaving the bulk of the investment risk with the buyer, Penn Mutual disqualified the instrument from exemption under §3(a)(8). See also *Otto*, 814 F.2d at 1140-42 (§3(a)(8) inapplicable when issuer has total control, after the fact, over the excess rate).

At first blush our case appears parallel to *Peoria Union*. AAP's contributions accumulated interest at the guaranteed minimum rates, plus the "excess" interest that Home Life's board of directors declared annually. This "excess", the parties agree, was derived from the rate of return Home Life earned on its general investment portfolio. Home Life stresses that by putting its entire portfolio behind the Flexible Annuity it reduced the buyers' risks—true enough, but equally true in *Peoria Union* and, for that matter, in any large mutual fund. A large, well-diversified portfolio has a small bankruptcy risk, but §3(a)(8) does not carve out of the securities laws all investments that are safe in this sense. Many investments have negligible bankruptcy risk but are still securities. Compare *Reves* with *Marine Bank v. Weaver*, 455 U.S. 551 (1982).

Yet one feature of the Flexible Annuity makes it look more like a fixed annuity than did the instruments in *Peoria Union* and *Otto*. In both of these cases (as in *VALIC* and *United Benefit*) the buyer paid money; the seller held it for a time, *after* which it announced the rate of interest to be credited. The *ex ante* uncertainty about that rate made the "annuity" look like a mutual fund, with the seller supplying only investment advice. Home Life, by contrast, announced the annual interest rate in advance. At the beginning of each policy year Home Life would declare a rate of return for the coming year. The terms of the Flexible Annuity left the purchaser free (a) to withdraw all funds and invest them elsewhere, if dissatisfied with the rate; (b) to leave the funds with Home Life and add nothing to them; and (c) to make additional purchases. AAP knew what rate of return it would earn for the next year not only before it made its initial contribution but also prior to deciding to "roll over" its investment each year thereafter. Had it found the declared rate unsatisfactory, it was free under the terms of the contract to take its money and go elsewhere. The Flexible Annuity, then, resembled nothing so much as a series of fixed annuities, each one year in duration, with the purchaser having an option to renew. That the return is fixed for such a short period does not make the instrument less an annuity.

AAP points out that if it had taken out its money during the first four years of the contract it would have incurred a withdrawal penalty. This front-end load covering sales and administrative expense did nothing to throw *investment* risk on the investor. (The same holds for any tax burden that might have befallen AAP had it demanded its money back.) AAP also argues that the Flexible Annuity provides no guarantee at all, that Home Life was free to change the interest rates at any time. *Otto* deemed such a reserved power fatal to the use of §3(a)(8).

Although the group annuity contract issued to AAP states that the interest rate for contributions under the

contract will be "declared annually by the Board of Directors", it does not expressly deny Home Life authority to modify the rate more than once a year. AAP submits that Home Life may alter interest rates at its discretion. In support of this claim, AAP points to the depositions of two of Home Life's officers describing how the Board of Directors arrived at the annual rate, and to a series of internal memoranda detailing the process by which the firm established interest rates for certain years. These documents show that Home Life did not assume a great deal of risk by guaranteeing an annual rate of return in advance: the declared rate was based on the performance of Home Life's portfolio over the past year, and only about 6% of the value of the portfolio was reinvested annually. The depositions and memoranda do not show, however, that Home Life varied during any year the interest rate for funds paid in prior to the declaration, or that it believed it had the authority to do so. In the early 1980s, when rates of return on other investments fluctuated rapidly, Home Life did begin to change more than once a year the rate of interest it would credit on *new* money. The rate declared on new funds was guaranteed through the remainder of the calendar year, but the changes in this rate did not affect the return on funds that had already been paid to Home Life in reliance on an earlier announcement. So far as this record reveals, then, Home Life neither claimed nor exercised the power to change rates after accepting funds, the power that spoiled the exemption in *Otto*, 814 F.2d at 1140-41.

The contract provides that interest rates are to be "declared annually" by Home Life's board of directors. This language most naturally means that the interest rates for amounts paid over to Home Life cannot be altered more than once per year. As the district court observed, this is how Home Life operated the Flexible Annuity program, and AAP has pointed to nothing in the voluminous record that suggests anything to the contrary. We therefore agree with the district court that Home Life's Flexible Annuities do not place excessive investment risk on the

purchaser and consequently are annuities. (State regulation is essential to the exemption under §3(a)(8); Home Life is regulated in many states, and Rhode Island in particular regulated the Flexible Annuity. Nothing in §3(a)(8) equates regulation with formal approval, so we make nothing of its absence.)

III

Next we take up AAP's claims under ERISA. AAP believes that Home Life, HTNB, and others involved in the preparation and sale of the group annuity contract violated their fiduciary duties under §404 of ERISA, 29 U.S.C. §1104, by failing to reveal that HTNB would reap the benefits of the float in the triple-transfer system employed to leave HTNB as the formal purchaser. Defendants reply that they are not fiduciaries under ERISA and argue that even if they are they violated no duties. The district court concluded that none of the defendants is an ERISA fiduciary. We believe that both Home Life and HTNB are ERISA fiduciaries but that the record does not permit a conclusion that they violated the duties they owed as fiduciaries.

HTNB is a trustee, but not the trustee of an ERISA plan established by an employer and therefore not a "named fiduciary" under 29 U.S.C. §1003(a). The ERISA *plan* is the one established by AAP. (Only a plan established by an "employer" is an ERISA plan. 29 U.S.C. §1002(2)(A).) AAP's plan names the Schwarzes, not any of the defendants, as trustees. Even without being named, a person is a fiduciary with respect to an ERISA plan to the extent: "(i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, . . . or, (iii) he has any discretionary authority . . . in the administration of such plan." 29 U.S.C. §1002(21). See *Forys v. United Food & Commercial Worker's International Union*, 829 F.2d 603 (7th Cir. 1987). AAP argues that Home Life and HTNB are

fiduciaries because they controlled the assets of AAP's defined benefit plan. But what are the plan's assets? Home Life placed AAP's contributions into its corporate portfolio, commingling them with, for example, the premiums paid for life insurance. Home Life has complete control over the composition of this portfolio and need not manage it to prefer pension claimants over the interests of insureds.

AAP argues that the defined benefit plan's assets included an equity interest in this investment portfolio to the extent of AAP's accumulated contributions and earnings, and consequently that Home Life's discretionary authority over these investments gives rise to a fiduciary duty. Yet §401(b)(2) of ERISA provides that where a plan purchases a "guaranteed benefit policy" from an insurer, the assets of the plan include that policy but not an interest in any assets of the insurer. 29 U.S.C. §1101(b)(2). A "guaranteed benefit policy" is an "insurance policy or contract . . . [that] provides for benefits the amount of which is guaranteed by the insurer." 29 U.S.C. §1101(b)(2)(B). We agree with the district court's conclusion that the Flexible Annuity is a guaranteed benefit policy because Home Life not only set fixed annual rates but also backed its promise with its full assets. It is difficult to see how an instrument could be an "annuity" for purposes of the securities laws and not be a "guaranteed benefit policy" for purposes of ERISA. Our discussion in Part II therefore establishes that Home Life was not holding its entire investment portfolio as AAP's fiduciary.

Still, the Flexible Annuity itself was an asset of AAP's plan. If HTNB and Home Life had discretionary authority over that instrument, they are ERISA fiduciaries. 29 U.S.C. §1002(21)(A)(i). HTNB held the Flexible Annuity in trust for the benefit of AAP's defined benefit plan. All the authority over the *disposition* of the Flexible Annuity rested with the the Schwarzes as trustees. HTNB's ministerial authority as holder of the paper does not create a fiduciary duty under ERISA. See *O'Toole v. Arlington Trust Co.*, 681 F.2d 94, 96 (1st Cir. 1982). AAP points

out that under Article VI of the corporate plan trust HTNB retained the power to appoint a trust administrator, a position to which it appointed Home Life immediately after the declaration of the trust. Authority of this kind creates a fiduciary duty under ERISA. *Leigh v. Engle*, 727 F.2d 113, 133-35 (7th Cir. 1984). *Leigh* observes, however, that the obligation as a fiduciary pertains only to the discretion thus created. See also, e.g., *Chicago Board Options Exchange, Inc. v. Connecticut General Life Insurance Co.*, 713 F.2d 254, 259 (7th Cir. 1983); *Landry v. Air Line Pilots Ass'n International*, 901 F.2d 404, 417-18 (5th Cir. 1990). So although HTNB is a "fiduciary", its obligation is only to use its limited discretion in the interest of the beneficiaries.

AAP claims that HTNB violated its duty to use contributions solely for the benefit of the plan. Home Life wired amounts it received from employers immediately to HTNB, which held them until the following Monday, obtaining as much as seven days' use of the money without paying interest to Home Life. Internal documents at Home Life pegged the total value of this float in 1980 at approximately $50,000 a year. Why this should be thought a breach of fiduciary duty eludes us. HTNB is entitled to compensation for its services as trustee. It contracted with Home Life to receive a portion of its compensation in the form of short-term interest-free use of funds. AAP concedes that Home Life began crediting contributions with interest from the day that the funds were received—exactly as would have occurred had HTNB not been an intermediary. Home Life, and not the purchasers, lost the value of the float, and the existence of the float therefore did not make it imprudent for HTNB to designate Home Life as the trust administrator (the only discretion it possessed).

Turning to Home Life, AAP argues that because Home Life retained the power to amend certain terms of the Flexible Annuity without the consent of the trustees of AAP's plan, it had discretionary control over the plan's asset and is a fiduciary. AAP relies on *Chicago Board Options Exchange*, 713 F.2d at 259-60, which held that

an insurer's authority to amend the terms of an annuity contract purchased to fund a retirement plan makes it a fiduciary under 29 U.S.C. §1002(21)(A). Once more, however, AAP's ability to establish that a defendant is a "fiduciary" does not aid its cause, for none of AAP's claims arises out of Home Life's exercise of this power. Cf. *Leigh*, 727 F.2d at 134. AAP's sole charge against Home Life is that it did not reveal the arrangements that allowed HTNB to profit from the float. That is unrelated to Home Life's power to amend the instrument. AAP suggests that if Home Life had not borne the costs of the float, its guaranteed rates of return would have been marginally higher. True enough: Home Life's costs of doing business reduced net returns payable to investors. Nothing makes the float stand out; the observation is equally true of *any* cost incurred in the administration of the Flexible Annuity. Although Home Life did not tell purchasers that HTNB was to enjoy the float, neither did it reveal its other costs of doing business—compensation to employees involved in administering the Flexible Annuity program, duplicating expenses, purchases of office equipment. None of these was calculated separately and stated to AAP and other investors, but all of them figured into the calculation of the rate of return. Home Life had no duty to calculate and disclose each expense of the Flexible Annuity program, so it violated no fiduciary duty by failing to inform AAP about the float.

AAP contends that two financial consulting firms specializing in designing pension plans, and their employees involved in designing AAP's defined benefit plan and recommending the Flexible Annuity to it, also violated their fiduciary duties under ERISA. These arguments are foreclosed by *Pappas v. Buck Consultants, Inc.*, 923 F.2d 531, 535 (7th Cir. 1991), which held that an actuary and his firm were not ERISA fiduciaries although they had performed misleading actuarial valuations of pension plan assets. In reaching this conclusion, we cited with approval a number of cases holding that providers of professional services are not ERISA fiduciaries. See *Anoka Orthopaedic Associates v. Lechner*, 910 F.2d 514, 517 (8th Cir.

1990) (lawyers and financial consultants); *Painters of Philadelphia District Council v. Price Waterhouse*, 879 F.2d 1146, 1149-51 (3d Cir. 1989) (accountants); *Nieto v. Ecker*, 845 F.2d 868, 870-71 (9th Cir. 1988) (lawyers). That lawyers, accountants, and actuaries may render services to employers, plan trustees, and plan beneficiaries does not give them any decision-making authority over the plan or plan assets; the power to act for the plan is essential to status as a fiduciary under ERISA.

IV

At last we arrive at AAP's RICO claims, which these days seem to be tacked onto securities and ERISA complaints as a matter of course. They should not be. Plaintiffs in a RICO action must show a "pattern" of racketeering, entailing proof of at least two of the felonies the statute specifies as predicate acts. 18 U.S.C. §1961(1). AAP's claims center on the float, which is no felony no matter what the outcome of AAP's fiduciary arguments. AAP characterizes Home Life's arrangement with HTNB both as an unlawful "kickback" (18 U.S.C. §1954) and as "embezzlement" of AAP's funds (18 U.S.C. §664). These arguments brought a little mirth to a complex case—but we suppose this was not the effect AAP sought.

Section 1954 makes it unlawful for a person to receive "any . . . kickback . . . because of or with intent to be influenced with respect to, any of his actions . . . relating to any question or matter concerning [an employee benefit] plan." The text of §1954 excludes "payment to or acceptance by any person of bona fide salary, compensation, or other payments made for goods or facilities actually furnished or for services actually performed." The district court correctly observed that "to label Home Life's payment of an additional fee to HTNB in the form of the float a 'kickback' is to ignore the substance of the transaction. Funds are not kicked back when two independent entities agree between themselves as to the payment to be made for services rendered". 751 F. Supp. at 729. Nothing so much as hints that HTNB received the float as

an inducement to perform some illegitimate act, so there is no "kickback". Cf. *Ranke v. United States*, 873 F.2d 1033, 1038-39 (7th Cir. 1989).

AAP's cry of embezzlement is equally silly. Embezzlement occurs when a person who has lawfully received funds wilfully diverts them to his own unauthorized use. *United States v. Marquardt*, 786 F.2d 771, 780 (7th Cir. 1986). Because the float arrangement was consensual between Home Life and HTNB, the bank was hardly embezzling Home Life's money.

Reduced to the mundane, AAP asserts that Home Life, HTNB, and the many actuaries, lawyers, and financial consultants involved in the transactions all committed wire and mail fraud. 18 U.S.C. §§ 1343, 1341. To show the "fraud" part of mail and wire fraud, AAP offers the affidavit of Dr. Schwarz, who states that he was assured that the Flexible Annuity offered rates of return equal to the highest in the market. This assertion is weird, for recall that to make the plan a more effective tax shelter Schwarz had to find an instrument with a relatively low rate of return. Let that pass. Fraud occurs only when a person of ordinary prudence and comprehension would rely on the misrepresentations. *Teamsters Local 282 Pension Trust Fund v. Angelos*, 762 F.2d 522, 529-30 (7th Cir. 1985). No prudent person would treat as gospel statements such as those Schwarz alleges were made to him. Statements that a certain investment will earn the "highest" rate of return are puffery. *Reynolds v. East Dyer Development Co.*, 882 F.2d 1249 (7th Cir. 1989). The relation between the rates offered on the Flexible Annuity and those available on other investments can be checked by a quick look at the *Wall Street Journal* or the *Chicago Tribune*. See *Blount Financial Services, Inc. v. Walter E. Heller & Co.*, 819 F.2d 151 (6th Cir. 1987) (misleading statements regarding bank's prime rate cannot be fraud where such information is publicly available). Any statement or implication that the Flexible Annuity provided that all earnings on Home Life's investments would be credited to AAP is refuted by the Flexible Annuity contract and the sales literature, which promise a guaranteed

rate of return plus an excess in the discretion of Home Life. Documents that unambiguously cover a point control over remembered (or misremembered, or invented) oral statements. *Zobrist v. Coal-X, Inc.*, 708 F.2d 1511 (10th Cir. 1983). "Unambiguously" is an important qualification, *Acme Propane, Inc. v. Tenexco, Inc.*, 844 F.2d 1317, 1322, 1325 (7th Cir. 1988); cf. *Virginia Bankshares, Inc. v. Sandberg*, 111 S. Ct. 2749, 2760-61 (1991), but one satisfied here. We agree with the district court that no jury could find that a reasonable investor would be misled by the statements Schwarz related, when the truth was under his nose in black and white (many times over). AAP cannot establish any predicate act, so the district court properly entered summary judgment on the RICO claims.

AFFIRMED

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX B

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

JUDGMENT—WITH ORAL ARGUMENT

Date: August 23, 1991

BEFORE:

Honorable John L. Coffey, Circuit Judge
Honorable Frank H. Easterbrook, Circuit Judge
Honorable Daniel A. Manion, Circuit Judge

No. 90-2800
ASSOCIATES IN ADOLESCENT PSYCHIATRY, S.C., MARVIN J. SCHWARZ and JOANNE G. SCHWARZ, trustees of the Defined Benefit and Defined Contribution Pension Plans and Trusts of AAP and of all beneficiaries and participants thereunder,

Plaintiffs-Appellants

v.

HOME LIFE INSURANCE COMPANY OF NEW YORK, a New York corporation, individually and doing business as QUALIFIED PENSION/PROFIT SHARING CONSULTANTS, INCORPORATED, QUALIFIED PENSION/PROFIT SHARING CONSULTANTS, INCORPORATED, a corporation, and CANAPARY FINANCIAL CORPORATION, a corporation, et al.,

Defendants-Appellees

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division
No. 82 C 4706, Judge John A. Nordberg

This cause was heard on the record from the above mentioned district court, and was argued by counsel.

On consideration whereof, IT IS ORDERED AND ADJUDGED by this Court that the judgment of the District Court in this cause appealed from be, and the same is hereby, AFFIRMED, with costs, in accordance with the opinion of this Court filed this date.

APPENDIX C

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

October 3, 1991.

Before

Hon. JOHN L. COFFEY, Circuit Judge
Hon. FRANK H. EASTERBROOK, Circuit Judge
Hon. DANIEL A. MANION, Circuit Judge

ASSOCIATES IN ADOLESCENT PSYCHIATRY, S.C., *et al.*,
Plaintiffs-Appellants,

No. 90-2800 v.

HOME LIFE INSURANCE CO., *et al.*,
Defendants-Appellees.

Appeal from the United States District Court for the
Northern District of Illinois, Eastern Division.
No. 82 C 4706—John A. Nordberg, *Judge*.

ORDER

Plaintiffs-Appellants filed a petition for rehearing and suggestion of rehearing en banc on September 6, 1991. No judge in regular active service has requested a vote on the suggestion of rehearing en banc, and all of the judges on the panel have voted to deny rehearing. The petition for rehearing is therefore DENIED.

APPENDIX D

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

JUDGMENT IN A CIVIL CASE

ASSOCIATES IN ADOLESCENT PSYCHIATRY, MARVIN SCHWARZ and JOANNE G. SCHWARZ etc.

v. Case Number: 82 C 4706

HOME LIFE INSURANCE, QUALIFIED PENSION PROFIT SHARING CONSULTANTS, CANAPARY FINANCIAL CORP., PHYSICIANS PLANNING SERV. ROBERT CANAPARY, RONALD AURE, DAVID COOPER, PENSION ACTUARIES, ERIC KRANKE, LEVENFELD, KANTER, BASKES and LIPPITZ and JERRY H. BIEDERMAN

☐ Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☒ Decision by Court. This action came to hearing before the Court. The issues have been heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that summary judgment is granted in favor of the defendants and against the plaintiffs on the RICO counts. Having previously granted summary judgment in favor of the defendants and against the plaintiffs on all of the federal claims, the Court, determining in its discretion pursuant to *Gibbs* not to exercise pendent jurisdiction over the state malpractice claim against the Levenfeld defendants, dismisses that claim without prejudice.

This is a final judgment.

July 23, 1990
Date

H. Stuart Cunningham
Clerk

APPENDIX E

[PLX 52 p. 3]

1980
DIVIDENDS FOR FLEXIBLE ANNUITIES
AND ANNUITY/PLUS
AND
INTEREST DECLARATION FOR AUXILIARY
FUNDS AND FOR PREMIUM
STABILIZATION RESERVE FUNDS

The Chairman reviewed Home Life's system under which invested assets are allocated among investment generations, and which is used in the determination of dividends or declared interest rates in our "new money" products. He also reviewed Management's plans to:

a) reinsure certain tax-qualified annuity products, and

b) introduce late in 1979 a new Flexible Annuity product to be substituted for the present version.

He proposed the following resolutions, which after discussion, on motions duly carried, were adopted:

"RESOLVED: That dividends for Flexible Annuities will be as follows in the first 3 months of 1980 (and the balance of 1979 for the new Flexible Annuity product) and, on provisional basis, in the last 9 months, with the provisional basis to be reconsidered by the Board after a review of the 1979 financial results and other factors:

The excess, if any, of (1) the amounts determined during the calendar year by applying the effective annual rates set forth below to the Participant's Accumulated Account Values, over (2) the interest calculated at the contractually guaranteed rates:

Gener.	Contribution Received	TAX QUALIFIED Current Product	TAX QUALIFIED New Product	NON TAX-QUALIFIED Current Product	NON TAX-QUALIFIED New Product
E	1980 and after	9.00%	9.25%	7.25%	7.50%
D	1974-1979	8.45	9.25*	7.25	7.50*

* Last Month of 1979

(2)

No. 91-1120

Supreme Court, U.S.
FILED
FEB 3 1992
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

ASSOCIATES IN ADOLESCENT PSYCHIATRY, S.C., MARVIN J. SCHWARZ and JOANNE G. SCHWARZ, Trustees of the Defined Benefit & Contribution Pension Plans and Trusts of Associates in Adolescent Psychiatry, S.C. and all Beneficiaries and Participants Thereunder,

Petitioners,

v.

HOME LIFE INSURANCE COMPANY OF NEW YORK, a New York Corporation, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; HOSPITAL TRUST NATIONAL BANK, a National Banking Association; CANAPARY FINANCIAL CORP., a Corporation; ROBERT CANAPARY, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; RONALD AURE, Individually and d/b/a Qualified Pension/Profit Sharing Consultants, Inc.; PENSION ACTUARIES, INC., a Corporation; ERIC KRANKE; LEVENFELD, KANTER, BASKES AND LIPPITZ, a Partnership; and JERRY BIEDERMAN,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

RESPONDENT HOME LIFE INSURANCE COMPANY'S BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

This case involves the application of the federal securities laws and ERISA to a pension plan's purchase of a flexible premium annuity contract from a state-regulated insurance company. The courts below, on their review of the undisputed facts, held that the "Flexible Annuity" contract at issue was not a security. The courts further held that the "Flexible Annuity" contract itself, and not the contributions paid to the insurer, was the asset held by the pension plan, and that the pension plan's claims of ERISA fiduciary breach did not arise out of any exercise of the insurer's discretionary powers with respect to that asset. The two questions presented are:

I.

Whether the insurance exemption from securities regulation of §3(a)(8) of the Securities Act of 1933 applies to a flexible premium annuity contract which guarantees principal and accumulated interest; guarantees a minimum 4% annual interest rate; declares excess dividend interest in advance and does not alter that excess interest for at least one year; and is issued by a state-regulated insurance company.

II.

Whether a flexible premium annuity: issued by, and backed by all the assets of, a state-regulated insurer; which guarantees principal and accumulated interest; guarantees a minimum 4% interest rate and declares excess dividend interest rates in advance and does not alter them; is a "guaranteed benefit policy" under ERISA §401(b)(2)(B).

PARTIES

In compliance with Rule 29.1, respondent, Home Life Insurance Company of New York, states that it is a mutual insurance company and has no parent or subsidiary companies within the meaning of Rule 29.1.

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No. 91-1120

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ASSOCIATES IN ADOLESCENT PSYCHIATRY, S.C., MARVIN J. SCHWARZ and JOANNE G. SCHWARZ, Trustees of the Defined Benefit & Contribution Pension Plans and Trusts of Associates in Adolescent Psychiatry, S.C. and all Beneficiaries and Participants Thereunder,

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STATEMENT OF THE CASE

In 1977, petitioner Associates in Adolescent Psychiatry, S.C. ("AAP"), as plan sponsor, established a defined benefit pension plan naming AAP as plan administrator, and petitioners Marvin J. Schwarz and Joanne G. Schwarz as trustees and investment managers. At the time, AAP already sponsored a defined contribution pension plan which named Marvin J. Schwarz as trustee.[1] To fund the pension plans, the trustees purchased from respondent, Home Life Insurance Company ("Home Life"), a whole life insurance policy and a flexible premium annuity contract called the "Flexible Annuity."[2] The contributions made to the Flexible Annuity by the pension plans were, as required by New York insurance law, deposited in Home Life's general account and commingled with all of Home Life's corporate assets, including premiums and contributions paid by policyholders for other non-pension insurance products.[3] The Flexible Annuity, as well as all of Home Life's general account insurance policies, was backed by all of Home Life's assets.[4] The Flexible Annuity guarantees principal and accumulated interest and a minimum 4% annual rate of return. In addition, Home Life declared, in advance, an annual excess dividend interest rate on

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[1] Uncontested Facts 1-3, 72-74. (The parties' exhibit list and a statement of Uncontested Facts were submitted to the District Court in a Final Pretrial Order on February 3, 1987.)

[2] Uncontested Fact 88.

[3] 729 F. Supp. at 1169, 1186.

[4] 729 F. Supp. at 1175.

existing deposits, which rate was never altered more frequently than once per year.[5]

Wishing to sell the Flexible Annuity nationwide, but desiring to avoid the time delays attendant to submitting the product for regulatory approval in every state on an individual basis, Home Life had structured the Flexible Annuity as a group annuity product. Home Life first sought regulatory approval in New York, its State of domicile, but due to the then-restrictive New York laws concerning the definition of a "group," Home Life filed and obtained approval of the Flexible Annuity in the State of Rhode Island. The Flexible Annuity was sold through a trust established at the Hospital Trust National Bank of Rhode Island to which Home Life issued the group annuity contract.[6]

The AAP pension plan made payments under the terms of the Home Life products until 1980. During this time, the return on Home Life's entire portfolio of assets (which was invested long-term) lagged behind the returns available from short-term investments prevailing in the skyrocketing interest rate environment of the early 1980s. Exhibiting buyer's remorse, the petitioners brought this action, originally alleging ERISA violations and subsequently adding securities fraud and RICO counts.[7] The district court granted summary judgment on all counts, first holding that the Flexible Annuity was not a security and was a guaranteed benefit policy (729 F. Supp. 1162) and subsequently holding that no predicate acts of fraud

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[5] Uncontested Fact 145, Joint Trial Exhibit 489.

[6] Uncontested Facts 10, 169-171; Plaintiffs' Exhibit 35.

[7] 941 F.2d at 565.

existed for purposes of the RICO counts (751 F. Supp. 727). The court of appeals affirmed (941 F.2d 561).[8]

The mail and wire fraud allegations, on which the Court of Appeals affirmed summary judgment, were essentially identical to the allegations of fraud and misrepresentation underlying the ERISA and securities fraud counts. Petitioners have not sought review of the Court of Appeals affirmance of summary judgment on the RICO claims.

REASONS FOR DENYING THE WRIT

INTRODUCTION

The petition for writ of certiorari continues petitioners' approach to this case of ever so subtly misstating and mischaracterizing the facts, and mischaracterizing what the lower courts in this case, and the decisions those courts relied on, found and held. Based on the uncontested material facts in the record, the Flexible Annuity is a garden variety insurance company annuity contract and is entitled to the insurance exemption in Section 3(a)(8) of the Securities Act of 1933. It is also appropriately described as a "guaranteed benefit policy" within the meaning of Section 401(b)(2) of the Employee Retirement Income Security Act ("ERISA") 29 U.S.C. §1101(b)(2). The decisions of the trial court and Circuit Court of Appeals carefully and correctly applied existing precedent. They break no new legal ground, and are not in conflict with

[8] At the time the petition for writ of certiorari was filed, apparently the Circuit Court of Appeal's opinion had not yet been published.

the decisions of this Court or any other Circuit Court of Appeals. The Seventh Circuit's decision was correct, and the writ should be denied.

A.

THE FLEXIBLE ANNUITY CONTRACT IS NOT A SECURITY.

Section (2)(1) of the 1933 Act (15 U.S.C §77(b)(1)) establishes the definition of the term "security" for the purposes of the statute. Under *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959) ("VALIC") and *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967) ("United Benefit") whenever a contract satisfies the definition of "annuity contract," contained in the exemption found in Section 3(a)(8) of the 1933 Act (15 U.S.C. §77(c)(a)(8)), the contract is not a security. This makes good sense because, as Justice Brennan observed in his concurring opinion in *VALIC*, there "was a form of 'investment' known as insurance (*including 'annuity contracts'*) which did not present very squarely the sort of problems that the Securities Acts . . . were devised to deal with, and which were in many details, subject to a form of state regulation of a sort which made the federal regulation even less relevant." (Emphasis added) *VALIC* at 75.

In concluding that the Flexible Annuity was entitled to the Section 3(a)(8) exemption the Seventh Circuit carefully analyzed, and its opinion is totally consistent with, the opinion of this Court in *United Benefit*. Unlike the Home Life Flexible Annuity which guarantees principal and accumulated interest, a minimum 4% interest return, and an excess dividend interest declared in advance, the minimum guarantee in *United Benefit* extended solely to the cash value of the contract holder's net premiums (principal). 387 U.S. at

205. Though the *United Benefit* contract holder was entitled to his proportionate share of the total investment fund, there was no guarantee that any earnings would accrue to the contract holder as a result of fund investment experience.

Petitioner's factual contentions concerning a conflict with *United Benefit* are simply untrue. The Flexible Annuity itself and the sales brochure received by petitioners[9] stated that the excess dividend interest rate would be declared annually by Home Life's Board of Directors at the beginning of each year. Yet, even in the face of the Seventh Circuit's clear factual findings to the contrary (941 F.2d at 567), petitioners argue that Home Life retained the right to alter interest rates at its discretion. Petitioners cite to PLX 52 (R. 422-1) as evidence of this contention. Petitioners fail to advise the Court that this document was created on November 19, 1979 and that, by the end of 1979, the 1980 declared interest rate for all of 1980: was unequivocally shown by separate letter dated December 31, 1979; was distributed to all Flexible Annuity contract holders; and was never modified. There is no evidence that that rate was "reconsidered" following "declaration" by communicating it to the contract holders. Petitioners further persist in confusing the distinction between dividend interest rates declared for existing deposits, and those declared prospectively for contribu-

[9] The trial court made a factual finding that the sales brochure, read as a whole, did not promote the Flexible Annuity primarily as an investment. Rather, the brochure repeatedly stressed that the Flexible Annuity was a method of saving for retirement with guaranteed principal, guaranteed interest, and a guaranteed life income. 729 F. Supp. at 1174.

tions which the pension plans might or might not make in the future.[10]

Finally, contrary to petitioner's erroneous contentions, and as the Seventh Circuit found, Home Life is regulated in many states, including its domiciliary state of New York and the Flexible Annuity was filed with the Rhode Island Department of Insurance. Home Life did not go to Rhode Island because of any objection to the Flexible Annuity policy form by the New York Insurance Department, or to avoid State insurance regulation, but because, at the time, New York insurance law would not recognize a "group" consisting of individuals who wanted to establish Individual Retirement Accounts and who did not have a common employer. Furthermore, the Flexible Annuity certificates were filed with the New York Insurance Department.[11]

Petitioner's arguments here merely rehash arguments made and rejected by both the trial court and the Seventh Circuit. The trial court and the Seventh Circuit, based upon their review of the undisputed facts, properly concluded that the Flexible Annuity met the §3(a)(8) exemption, and entered and affirmed summary judgment on the federal securities law claims.

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[10] In adopting Rule 151 (17 C.F.R. 231.151) (a safe harbor for certain annuity contracts) the SEC has specifically approved differing first year rates for deposits made at different times during that first year. *See* FED. SEC. L. REP. 84,004 at 88,134-35. The Seventh Circuit acknowledged that Rule 151 might facilitate understanding of the statutory law, but because the flexible annuities were developed and sold to the pension plans prior to the issuance of the rule, it did not affect the disposition of the case which was decided under §3(a)(8). 941 F.2d at 565. Petitioners' reference to ERISA §404(a)(1)(D) is misplaced and irrelevant.

[11] R. 350-2, Exh. C.

B.

HOME LIFE HAD LIMITED FIDUCIARY OBLIGATIONS AND DID NOT BREACH THEM.

The Seventh Circuit correctly concluded that the Flexible Annuity was a "guaranteed benefit policy" within the meaning of ERISA; that therefore the insurance contract itself was the asset held by the pension plans; and that Home Life had not violated any fiduciary obligations it might have with respect to any discretion it retained to deal with the Flexible Annuity contract itself. The Seventh Circuit held that:

> The Flexible Annuity is a guaranteed benefit policy because Home Life not only set fixed annual rates but also backed its promise with its full assets.

941 F.2d at 568. This is entirely consistent with the conclusion of the Seventh Circuit that, because of its annual declaration of dividend interest rates in advance, the Flexible Annuity "resembled nothing so much as a series of fixed annuities, each one year in duration, with the purchaser, having an option to renew." 941 F.2d at 567. Because the pension plans could withdraw their funds from the Flexible Annuity at any time, and because the accumulated amount plus the guaranteed return for the coming year were always known to the pension plans, the amount of benefits within Home Life's control was fully guaranteed at all times.

The Seventh Circuit's conclusion is not in conflict with the legislative history of ERISA. The original pension reform bills, H.R.2 introduced on January 3, 1973 and S.4, introduced on January 4, 1973, and passed by the House and Senate, were in general agreement that funds held by an insurance carrier in its general assets account would not be subject to ERISA fiduciary responsibilities. Sec-

tion 511 of the Senate bill specifically provided that fiduciary obligations would not apply to "funds" held by an insurance carrier unless that carrier holds funds in a separate account. The House bill did not contain a specific provision on this subject; however, a summary of the differences between the two bills prepared by the cooperating committee staffs, noted that the Senate bill attached no fiduciary duties to "funds held by an insurance carrier unless they are held in a separate account" and that "[a]lthough the House bill does not specifically exempt these funds from the fiduciary responsibility rules, the policy of the House bill is the same." Summary of Differences Between the Senate Version and the House Version of H.R.2, pt. 3, 94th Cong., 2d Sess. at 2 and n.3 (1974), *reprinted in* 3 Staff of Senate Comm. on Labor & Public Welfare, 94th Cong., 2d Sess. Legislative History of ERISA at 5252 (Comm. Print 1976). While the Seventh Circuit did not specifically analyze this history, its conclusion is entirely consistent with it.

The Seventh Circuit's conclusion is also consistent with early administrative interpretation by the Department of Labor concerning the meaning of the term "guaranteed benefit policy." The Department's position is that, if the trustee of a plan purchases an insurance policy or contract and the consideration is placed in the insurer's general asset account, the assets of the general account are not plan assets. Interpretive Bulletin 75-2 (Feb. 6, 1975), 29 C.F.R. §2509.75-2 (1984) ("I.B. 75-2"). I.B. 75-2 states,

> "if an insurance company issues a contract or policy of insurance to a plan and places the consideration for such contract or policy in its general asset account, the assets in such account shall not be considered to be plan assets."

This position was reaffirmed by the Labor Department on a number of more recent occasions. *See* 44 Fed. Reg. 46365, 46368 (Aug. 7, 1979); 44 Fed. Reg. 50363, 50364 n.4 (Aug. 28, 1979); 45 Fed. Reg. 51303, 51304, 51305 n.9 (Aug. 1, 1980); 46 Fed. Reg. 46443, 46444 (Sept. 18, 1981). This interpretation was accepted by the court in *Harris Trust and Savings Bank v. John Hancock Mutual Life Ins. Co.*, 722 F.Supp. 998, 1018-19 (S.D.N.Y., 1989) ("Harris Trust").

The *Harris Trust* court buttressed its conclusion by noting the fact that the Department of Labor had published a final regulation dealing with the definition of "plan assets." 51 Fed. Reg. 41280 (Nov. 13, 1986). 29 C.F.R. §2510.3-101. *Harris Trust* concluded that if, in regulating plan assets, the Department made no mention of insurance company general account contracts, and specifically left intact paragraph (b) of I.B. 75-2, the Department did so because, in its view, general account contracts such as the Flexible Annuity do not give an insurer control of plan assets. 722 F. Supp. at 1019.

The Seventh Circuit's holding is also consistent with the result reached by the trial court after it thoroughly analyzed these same plan asset regulations. The trial court began by noting that it was the intent of the regulation to look through the form of an entity to hold it directly liable as a fiduciary with respect to plan assets ostensibly used to purchase an equity interest in that enterprise. 729 F. Supp. at 1183. The court then noted the general rule stated in REG. §2510.3-101(a)(2), that a plan's acquisition of a non-equity interest in an entity will not give the plan a share of the *entity's* assets. 729 F. Supp. at 1185. The trial court then quickly and correctly concluded that a plan's possession of an ordinary participating insurance contract would be viewed as giving it a debt interest in the insurer under New York law, and that the plan asset

regulations would generally exempt Home Life from ERISA fiduciary duties. 729 F. Supp. at 1186. The court then reviewed the features of the Flexible Annuity which included both: a guarantee of the principal amount of contributions and credited interest; and excess interest rate at all times declared in advance of payment and for a specified period. The court concluded that, because of those guarantees, Home Life was the party which bore the risk of loss on the contributions made under the contract, and that therefore the FA was not the sort of defacto investment management that the look through rule of the plan asset regulations was designed to reach. 729 F. Supp. at 1188.

Finally, the Seventh Circuit's conclusion does not conflict with the Third Circuit's opinion in *Mack Boring & Parts v. Meeker Sharkey Moffit*, 930 F.2d 267 (3d Cir. 1991). Both the Third Circuit and the Seventh Circuit reached the same conclusion, namely, that the insurance policies involved in both cases were "guaranteed benefit policies." Petitioners make no effort to demonstrate that the Flexible Annuity and the insurance policy involved in *Mack Boring* are factually similar, and in fact they are not. Under those circumstances, the fact that the Seventh Circuit in the instant case used a different analysis to reach the same result as that of the Third Circuit in *Mack Boring* is not surprising, and certainly no conflict in the Circuits is created.

C.

THE ISSUES PRESENTED ARE NOT IMPORTANT BEYOND THE LITIGANTS TO THIS CASE.

The trial court properly granted, and the Seventh Circuit properly affirmed, summary judgment to the defendants. They did so by carefully analyzing and applying

existing law and concluding that when a pension plan purchases a traditional annuity contract, it buys neither a security nor creates ERISA fiduciary obligations with respect to the premiums paid to the insurer. Petitioners have not sought review of the Seventh Circuit's affirmance of the trial court's finding that no actionable fraud or misrepresentations occurred. Because this finding would sharply limit the scope of further proceedings on any remand, and because the Seventh Circuit's decision breaks no new legal ground and does not conflict with the decisions of this Court or those of other Circuits, the special and important reasons which would cause this Court to exercise its discretion and grant a full review in this case simply do not exist.

CONCLUSION

For the foregoing reasons, respondent, Home Life Insurance Company of New York, prays that this Court deny the petition for writ of certiorari to the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

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Introduction

Home Life's Brief in Opposition attempts to perpetuate the error of the court of appeals by ignoring the reason this litigation was brought and prosecuted: to examine, expose and redress self dealing with retirement assets by an insurance company and its associates. The court below ruled that the petitioners had no right to question Home Life's and the Bank's practices of imposing hidden and unauthorized charges in computing the "flexible" portion of the earnings of petitioners' retirement funds—an act of judicial legislation that exempts a risk-shifting investment contract from the securities laws and ERISA.

Should this court deny certiorari, the rest of the insurance industry will surely walk through the door opened by Home Life, the Bank and the Seventh Circuit—a door that leads to judicially created deregulation of a major portion of two areas that Congress has consistently sought to regulate: securities and retirement benefits.

A. The Flexibility Annuity Contract Is A Security.[1]

Home Life's brief in opposition attempts to minimize its corporate resolution (PLX 52; Appendix D to Petition), which reserves the right to alter interest rates at Home Life's discretion, by arguing that in 1980 Home Life did not in fact "reconsider" the declared rates. (Brief in Opposition, p. 5.) Yet, Home Life has not contested the fact

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[1] Home Life's statement that petitioners do not seek review of the lower courts' findings regarding fraud and misrepresentation (Brief in Opposition, p. 11) is wrong. Petitioners seek review and reversal of the rulings that respondents are not subject to the anti-fraud provisions of the federal securities laws and ERISA's fiduciary rules.

that it unilaterally reserved the *right* to alter the declared rates on both *old and newly invested* money, based on its investment performance, thereby shifting the investment risk to petitioners and other holders of the Flexible Annuity. It is this shifting of risk that makes the Section 3(a)(8) exemption inapplicable to the Flexible Annuity and similar investment vehicles.

Because Home Life does not dispute that the parties stipulated as uncontested fact that Rhode Island had no statute regulating group annuities,[2] Home Life cannot argue that Rhode Island regulated the Flexible Annuity, a fallacious finding by the court below. Indeed, Home Life chose Rhode Island for its group trust with the Bank because of the absence of regulation in that state—a state which has seen its financial institutions ravaged by its lack of regulation.[3]

B. General Account Insurance Contracts Do Not Enjoy Legislative Or Administrative Exemption From ERISA's Fiduciary Rules.

Contrary to respondent Home Life's assertions, the insurance industry has always understood that ERISA, as interpreted by the U.S. Department of Labor ("DOL"), did not exempt all general account assets from fiduciary status.[4] Beginning in 1976 and continuing through the

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[2] Uncontested Fact Nos. 162, 170, 171.

[3] *See*, "Rhode Island Governor Closes 45 Institutions," *Wall Street Journal*, January 2, 1991, Section A, Page 2.

[4] For a complete analysis of the insurance industry's legislative and administrative attempts to exempt itself from ERISA fiduciary duties, *see* Kill, *Statutory History Points Toward Coverage of Insurer's Account*, Nat'l L.J., Nov. 5, 1990, at 32-33. The following paragraphs draw from the material in that article.

1980's, the American Council of Life Insurance (ACLI), the insurance industry's trade group and lobbyist, began lobbying Congress, unsuccessfully, to unambiguously relieve insurance companies issuing contracts from their general accounts from ERISA's fiduciary duties. ACLI then made a serious and concerted effort to obtain DOL approval of, or at least non-opposition to, its position. In 1984 and 1985, DOL declined to support ACLI's legislative proposals. In essence, DOL believed that pension funds in insurers' general accounts, under certain circumstances (e.g., where, as in the instant case, the customer participates in the investment experience of the insurer), required federal regulation of the insurance companies.

DOL also objected to ACLI's efforts to exempt *all* general account group annuity contracts entered into before the 1984-1985 legislative proposals' effective date, and to characterize contracts which merely provide a guarantee of principal as "guaranteed" and thus exempt from ERISA's fiduciary requirements. Thereafter, in late 1985, ACLI attempted to codify DOL Interpretive Bulletin 75-2, dealing with prohibited transactions, through an amendment to the Budget Reconciliation Bill of 1985.[5] Again, the effort failed. DOL's continuing resistance led ACLI to abandon its legislative proposals and instead to work for an acceptable "safe harbor" in DOL's regulations on plan assets. This effort also failed.[6]

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[5] Home Life misrepresents DOL Interpretive Bulletin 75-2 as a blanket exemption from ERISA's fiduciary duties, rather than a limited exemption from ERISA's prohibited transaction rules to which the Bulletin applies. In its final 1986 plan asset regulation, DOL made clear its intent that IB 75-2, as amended, applies only to DOL's interpretation of ERISA's prohibited transaction rules. 51 Fed. Reg. 41262, 41278 (No. 219 Nov. 13, 1986).

[6] *See* fn. 4, *supra*.

Unless this Court reverses the decision of the lower court in this case, the insurance industry will have achieved by judicial fiat an exemption from ERISA's fiduciary duties that ACLI could not accomplish in more than fifteen years of concerted legislative and administrative lobbying.

C. Home Life And The Bank Violated Their Fiduciary Duties Under ERISA.

By seeking to preserve the court of appeals' decision, Home Life arrogates to itself the concurrent powers to: (i) market its investment expertise to ERISA plans; (ii) avoid ERISA fiduciary responsibility for making investment decisions by characterizing its products as general account policies; (iii) affect ERISA plans' returns by unilaterally charging undisclosed and unauthorized expenses and fees; (iv) shift investment risk to ERISA plans; and (v) enjoy, by means of judicial conflict, a freedom from regulatory accountability that the insurance industry has repeatedly failed to obtain through legislative initiative.

Home Life's Brief in Opposition seeks to distract the Court's attention from, (a) Home Life's claimed power to adjust investment returns, and (b) its exercised power to reduce investment returns through unilaterally determined and undisclosed fees and charges. It does so by making the irrelevant suggestion that it did not exercise the former power and by ignoring its exercise of the latter power. Home Life's brief compounds this distraction by a lengthy discourse on the alleged consistency between inconsistent holdings of the Third and Seventh Circuits on the definition of a guaranteed benefit contract. The decision in this case, unlike the correct decision in *Mack Boring*,[7] ignores

[7] *Mack Boring & Parts Co. v. Meeker Sharkey Moffit*, 930 F.2d 267 (3d Cir. 1991).

the fact that ERISA shields insurers from pension regulation only "to the extent" that they guarantee retirement benefits to plan participants.[8] The insurance industry's legislative and administrative efforts attempted unsuccessfully to eliminate the above-quoted language, which the Seventh Circuit's opinion has effectively and literally excised from its reading of ERISA. (App. A, pp. 11-12.)

Thus, respondents cannot escape the conclusion that "to the extent" the Flexible Annuity did not guarantee a retirement plan's benefits—i.e., the "flexible" portion of the return that depended upon the performance of Home Life's investments and the manner in which it handled those investments—it is not exempt from ERISA's fiduciary duties. Yet, the court of appeals erroneously exempted this portion of the return on the Flexible Annuity that Home Life and the Bank manipulated by self-dealing.

D. The Issues Presented Are Important Enough to Justify Granting the Writ.

Home Life's Flexible Annuity and similar products are not "traditional annuity contracts." (Brief in Opposition, p. 11.) They are risk-shifting investment vehicles that their managers should regard with the same respect due other retirement assets. To exempt these instruments completely from securities *and* ERISA regulation puts the 62 million Americans' $713 billion in retirement assets invested with insurance companies[9] at grave risk. This issue is especially urgent because the insurance industry itself faces unprecedented solvency problems.[10]

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[8] ERISA § 401(b)(2)(B), 29 U.S.C. § 1102(b)(2)(B).

[9] *See*, Petition, fn. 6, p. 7.

[10] *See*, "Life Insurer's Loans On Real Estate Cause Ever-Rising Worries," *Wall Street Journal*, January 31, 1992, Section A, p. 1.

The court of appeals in this case substituted a judicially crafted, rather than the congressionally mandated, standard for exemption from ERISA fiduciary rules. The holding in this case substitutes the *timing* of the exercise of Home Life's power to determine and declare the Flexible Annuity's excess rate (i.e., at the beginning versus the end of the year) rather than *the extent to which* such power insures the payment of the promised deferred compensation (i.e., whether Home Life guarantees *less than all* the retirees' pension benefits). Because the decision in this case has the startling result of shielding discretionary, risk-shifting conduct from scrutiny under both the securities laws and ERISA without a showing of state regulation, petitioners urge this Court to grant the writ of certiorari and reverse the ruling below.

Respectfully submitted,

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